IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE ENRON CORPORATION SECURITIES LITIGATION,) CIVIL ACTION NO. H-01-3624 Consolidated

THIS DOCUMENT RELATES TO: All Cases Consolidated with Newby)

ADDITIONAL MEMORANDUM OF LAW, SUBMITTED IN LIGHT OF THE CONSOLIDATED COMPLAINT FILED BY THE CALIFORNIA REGENTS, IN FURTHER SUPPORT OF THE PREFERRED PURCHASER PLAINTIFFS' MOTIONS FOR CLARIFICATION (WITH EXPEDITION) OF THIS COURT=S MEMORANDUM AND ORDER DATED FEBRUARY 15, 2002

Henry H. Steiner, Daniel Kaminer, Christine Benoit, Michael and Jennifer Cerrone, and Harold Karnes (the APreferred Purchaser Plaintiffs@), submit this additional memorandum in support of their pending motions for expedited clarification of this Court=s February 15, 2002 Memorandum and Order (the AOpinion@) appointing lead plaintiff and lead counsel. This motion by the Preferred Purchaser Plaintiffs was made on March 20, 2002. The lead plaintiff (the Regents of the University of California, hereinafter "Regents") filed its response the next day, March 21, 2002. The motion was fully briefed as of March 22, 2002, when movants filed their reply. This memorandum is submitted: (a) after reviewing lead plaintiff's purportedly exhaustive 503 page Consolidated Complaint (hereinafter sometimes "CC") filed by the Regents on April 8, 2002 and (b) in light of the breakdown of the settlement negotiations and the fact that these cases will now move forward on an expedited basis toward an early trial.

After reviewing the Consolidated Complaint, the Preferred Purchaser Plaintiffs assert that the Regents have failed to bring, on behalf of the class of those who purchased Enron preferred stock, cognizable claims under Texas state law, despite the fact that the Regents did assert similar Texas state law claims on behalf of those who purchased certain Enron debt securities. Accordingly, the worst fears of the Enron preferred stock purchasers appear to have come to pass: the attorneys for the Regents refused to consult with the attorneys for the Preferred Purchaser Plaintiffs, and

682

certain of the Enron preferred stock purchasers' unique claims will be forever lost if this Court does not order expeditious action. The Preferred Purchaser Plaintiffs renew their request that: (1) Milberg, Weiss be required to consult with the attorneys for movants; (2) given that a Consolidated Complaint has been filed which omits certain cognizable claims of Enron preferred stock purchasers, this Court direct Milberg Weiss to file an Amended Consolidated Complaint alleging those claims on behalf of Enron preferred stock purchasers; and (3) this Court appoint the attorneys for the Preferred Purchaser Plaintiffs to represent purchasers of Enron preferred stock in the same manner that the Berger & Montague law firm, and the Wolf Popper and Shapiro Haber & Urmy law firms, are representing the respective interests of the purchasers of certain Enron debt securities. See Consolidated Complaint at page 500 (listing these law firms as the attorneys for particular purchasers of debt securities).

I. THE CONSOLIDATED COMPLAINT CONTAINS CLAIMS UNDER TEXAS STATE LAW ON BEHALF OF PURCHASERS OF ENRON DEBT

Claim four of the Consolidated Compliant is brought under the Texas Securities Act. The claim concerns Enron's sale on July 7, 1998 of both $250 million of 6.40% Notes dues 7/15/06 and $250 million of 6.95% Notes due 7/15/2028. CC ¶111. JP Morgan and Lehman Brothers acted as underwriters for these sales, via a prospectus, and both underwriters are named as defendants. CC ¶¶111, 1019. The two offerings were pursuant to a Registration Statement, the effective date of which apparently was December 31, 1997. See CC ¶612. In any event, the effective date of the Registration Statement must have been prior to the offering date.

Most significantly, the issuance of these Notes, and the effective date of the Registration Statement, took place prior to the beginning of the Federal Class Period, which the Regents allege began on October 19, 1998 (CC ¶121). To be sure, the factual discussion of the state law claims concerning the Notes is contained in a section of the Consolidated Complaint entitled "Background to the Class Period" (meaning the Federal Class Period). CC at page 106. The named plaintiff on these claims is the Washington State Investment Board, which purchased these two issues of Enron debt securities pursuant to the prospectuses. CC ¶¶81, 1018.

These claims were brought under the Texas Securities Act because the torts, using that term generically to mean the two July 7, 1998 offerings, occurred before the commencement of the three year statute of limitations period under the federal securities laws, meaning the offerings were before October 19, 1998. Under the Texas Securities Act, a claim must be brought both: (a) within three years after discovery of the untruth or omission, or after discovery should have been made by the exercise of reasonable diligence and (b) within five years of the transaction at issue. Art. 581-33 H. (2) (a) and (b). The Consolidated Complaint alleged these facts as to the named plaintiffs and the other members of the Notes subclass. CC ¶1030.

The named defendants on claim four are Arthur Andersen LLP ("Andersen"), Robert A. Belfer, Norman P. Blake, Jr., Richard B. Buy, Richard A. Causey, Ronnie C. Chan, John H. Duncan, Andrew Fastow, Joe H. Foy, Wendy L. Gramm, Ken L. Harrison, Robert L. Jaedicke, Kenneth L. Lay, Charles A. LeMaistre, Jerome J. Meyer, Jeffrey K. Skilling, John A. Urquhart, John Wakeham, Charls E. Walker, Bruce G. Willison, Herbert S. Winokur, Jr., and the underwriters JP Morgan and Lehman Brothers.

II. THE REGENTS SHOULD HAVE BROUGHT SIMILAR STATE LAW BASED CLAIMS ON BEHALF OF ENRON PREFERRED STOCK PURCHASERS

A. The Regents Should Have Brought Two Claims Under the Texas Securities Act Concerning Two Enron Preferred Stock Offerings

There were two offerings of Enron preferred stock prior to the Federal Class Period, concerning the issuance of Enron Capital Trusts I and II. Just as the Regents filed Texas state law claims under the Texas Securities Act for certain pre-Federal Class Period debt claims, the Regents should have filed a state law based claim on behalf of Enron preferred stock purchasers under the Texas Securities Act with respect to these offerings.

The offering for Capital Trust I, for 8 million shares of trust preferred securities at $25.00 per share took place on November 21, 1996. The underwriters for this offering were Merrill Lynch, Dean Witter Reynolds Inc., A.G. Edwards & Sons, Inc., PaineWebber Incorporated, Rauscher Pierce Refsnes, Inc. and Smith Barney Inc. The signatories to the offering documents included Kenneth L. Lay, Robert H. Butts, William D. Gathmann, Robert A. Belfer, Norman P. Blake, Jr., Ronnie C. Chan, John H. Duncan, Joe H. Foy, Wendy L. Gramm, Robert L. Jaedicke, Richard D. Kinder, Charles A. LeMaistre, John A. Urquhart, John Wakeham, Charls E. Walker, Herbert S. Winokur, Jr., Peggy B. Menchaca. James V. Derrick, Jr., Enron's General Counsel, also was involved in the offering. Fourteen of these eighteen individuals (all but Butts, Gathmann, Kinder and Menchaca) are named as defendants in the Consolidated Complaint. Merrill Lynch is a defendant in the Consolidated Complaint.

The offering for Capital Trust II, for 6 million shares of trust preferred securities at $25.00 per share, took place on January 13, 1997. The principal underwriters for the Capital Trust II offering were Merrill Lynch, Bear, Stearns, A.G. Edwards, PaineWebber, Prudential Securities and Smith Barney.[1] Seventeen of the eighteen individuals (all but Mr. Kinder) identified in the paragraph immediately above were involved in the Cap Trust II offering, and the same fourteen individuals are named defendants herein.

The Prospectus for both offerings incorporated by reference the 10-K for 1995 and Enron's three 10-Qs for the first three quarters of 1996, ending September 30, 1996. The

---

[1] Each of these six principal underwriters purchased 880,000 shares (totaling 5,280,000) of the Cap Trust II offering. The remaining 720,000 shares were equally divided among 12 other firms.

defendants' alleged unlawful conduct started years before the beginning of the Federal Class Period in October 1998, and even before the restatement of Enron's earnings which as of now goes back to January 1, 1997. The Regents utilize this fact in bringing the Notes claims against the defendants for their conduct during the period prior to October 1998. See CC ¶612 (noting that Enron's 1996 10-K was incorporated by reference into other prospectuses).[2]

Hence, on behalf of Enron preferred stock purchasers, the Regents should have brought two Texas Securities Act claims concerning the two preferred stock offerings but it did not do so.[3]

B. The Regents Also Failed to Allege that the Two Enron Preferred Stock Offerings Constituted Negligent Misrepresentation Under Texas State Law

The Regents also failed to bring claims concerning the two Enron preferred stock offerings under Texas state law based upon negligent misrepresentation in the prospectus.

---

[2] Newspaper accounts of the fall of Enron illustrate that defendants' illegal conduct was well under way prior to this time. ENRON'S MANY STRANDS: THE TRANSACTIONS; The Financial Wizard Tied to Enron's Fall," The New York Times, Feb. 6, 2002, §A at 1 (By 1993, the partnerships established by Enron were so successful that CALPERS approached Enron about a joint venture, and JEDI was formed. As early as 1997, Enron had difficulty finding a partner to buy out CALPERS interest.); "ENRON'S COLLAPSE: REGULATIONS; Exemptions Won in '97 Set stage for Enron Woes," The New York Times, Jan. 23, 2002, §A at 1 (1993 exemption from the tough restrictions imposed by the Public Utility Holding Company Act); "ENRON'S COLLAPSE: THE SYSTEM; Web of Safeguards Failed as Enron Fell," The New York Times, Jan. 20, 2002, § 1 at 1 (1993 ruling by CFTC exempted energy trades from commission review).

[3] Nor is there a statute of limitations issue. The claims would have been brought within three years of discovery by reasonable diligence. Further, the original complaint by the Preferred Purchaser Plaintiffs was filed on approximately October 30, 2001, less than five years after both preferred stock offerings. Throughout this action, the Preferred Purchaser Plaintiffs' papers filed with this Court have referred to the Enron preferred stock purchasers' potential IPO-like claims with respect to these offerings, and that further factual investigation was ongoing. Newby Docket numbers, e.g., 73 (Initial Mem. in support at page 4), 167 (Response Mem. in support, §II.C. at 12-13). In addition, the truth concerning the activities of Enron and Andersen has unfolded over many months, and is still unfolding. See Fed. R. Civ. Pro. 15 (c) (relation back doctrine). The bottom line is that the Regents have failed to assert these claims.

In their amended complaint filed November 30, 2001, the Preferred Purchaser Plaintiffs alleged a claim against Enron, Andersen, and Lay, Skilling and Fastow, based upon negligent misrepresentation under Texas state law, that the defendants were negligent in disseminating false information about Enron (but that they acted without scienter). This claim concerned open market purchases and similarly was limited to the time period from January 21, 1997 through approximately October, 1998, so that it included only a time period prior to the Federal Class Period. For the reasons discussed in the section above, the Regents failed to assert claims which it should have brought on behalf of Enron preferred stock purchasers with respect to negligent misrepresentation in these two preferred stock offerings.

Negligent misrepresentation is defined under Texas law as being a claim sounding in negligence rather than fraud. The statute of limitations for negligent misrepresentations is two years. US MCT, Inc. v. Brodsky, 2001 Tex. App. LEXIS 7498 at *21 (Ct. App. 5th Dist., Nov. 7, 2001); Texas American Corp. v. Woodbridge Joint Venture, 809 S.W.2d 299, 303 (Ct. App. 2d Dist. 1991); Tex. Civ. Prac. & Rem. Code Ann. 16 §16.003. However, Texas also utilizes a "discovery rule" that a negligent misrepresentation claim may be brought within two years of its discovery. See Texas American Corp. v. Woodbridge Joint Venture, 809 S.W.2d 299, 303 (Ct. App. 2d Dist. 1991); Jampole v. W. Douglas Matthews, 857 S.W.2d 57, 60-61, 63-64 (Ct. App. 1st Dist. 1993). The rule tolls the running of the statute of limitations until the plaintiff discovers, or through the exercise of reasonable care and diligence should discover, the nature of its injury. Jampole v. W. Douglas Matthews, 857 S.W.2d 57, 63 (Ct. App. 1st Dist. 1993). It is axiomatic that the discovery rule is more favorable to a plaintiff than a fraudulent concealment rule.

More pointedly, one Texas Court of Appeals has held in a well-reasoned opinion that the discovery rule applies to negligent misrepresentation actions against accountants even when the claims are raised by non-client third parties. Trustee v. Grant Thornton, 973 S.W. 2d 348, 364-65 (Ct. App. 9th Dist. 1998), Fed. Sec. L. Rep. (CCH) ¶90,233.[4]

These claims were not asserted in the Consolidated Complaint. Further, since one of Andersen's defenses is that it was lied to by Enron, see newspaper articles passim, clearly that leaves available a claim that Andersen was negligent even if it did not possess scienter.

C. The Regents Failed to Reallege the Claim Asserted by the Preferred Purchaser Plaintiffs, Based Upon Negligent Misrepresentation Under Texas State Law, Concerning Open Market Purchases

In their amended complaint filed November 30, 2001, the Preferred Purchaser Plaintiffs alleged a claim against Enron, Andersen, and Lay, Skilling and Fastow, based upon negligent misrepresentation under Texas state law, that the defendants were negligent in disseminating false information about Enron which artificially inflated the price of open market purchases of Enron preferred securities. This claim similarly was limited to the time period from January 21, 1997 through approximately October, 1998, so that it included only a time period prior to the Federal Class Period.

For the reasons set forth above, this claim should have been asserted. Milberg Weiss simply omitted this claim from their consolidated complaint.

---

[4] Contra Brown v. KPMG Peat Marwick, 856 S.W.2d 742 (Tex. App. El Paso 1993, writ denied). The Grant Thornton Court characterized the Brown holding – that the discovery rule does not toll limitations in a suit filed against an auditor by a non-client who charges negligence in the performance of an audit – as based upon justice and policy considerations behind the statute of limitations. The Grant Thornton Court then stated that it did not agree with the Brown Court's "blanket holding." Grant Thornton, 973 S.W. 2d at 365.

III. MILBERG WEISS, AS LEAD COUNSEL IN BOTH THE ENRON AND QWEST SECURITIES CLASS ACTIONS, HAS A CONFLICT WHCH MAY REQUIRE IT TO ACT ADVERSELY TO THE INTERESTS OF THE ENRON PLAINTIFFS

Arthur Andersen is a defendant in the In re Qwest Communications International, Inc. Securities Litigation, Civ. No. 01-N-1451 (D. Colorado), as well as a defendant in this class action (and perhaps in additional class actions), all of which are being prosecuted by Milberg Weiss as lead counsel. Since the demise of Andersen seems more likely with the passing of each day, its resources and assets will likely constitute a limited pool of funds. As lead counsel in the Qwest securities litigation, Milberg Weiss will be responsible for directing and initiating settlement discussions with Andersen. See In re Ivan F. Boesky Sec., 948 F.2d 1358 (2ns Cir. 1991). Having Milberg Weiss continue as sole lead counsel in the case at bar may very well saddle it with conflicting loyalties.[5] In executing its duty to maximize the recovery for Qwest plaintiffs, Milberg may adversely affect the interest of the Enron plaintiffs because the assets of Andersen are limited. Indeed, the limited pool of resources creates a zero-sum scenario where each dollar recovered by one class of plaintiffs in one action limits the recovery of a competing class in the other action on a dollar for dollar basis.

Whether this scenario materializes is only part of the problem facing Milberg Weiss. The appearance of this potential conflict will invariably raise questions about the fairness of any class settlement between the proposed class of Enron preferred shares purchasers and

---

[5] In *In re San Juan Dupont Plaza Hotel Fire Litig.,* 111 F.3d 220, 234 (1st Cir. 1997), the court held that the attorney serving on the executive committee owes a fiduciary obligation to the plaintiffs, regardless of the lack of a formal attorney-client relationship.

Andersen.[6] In the class action context, counsel representing the class must take all measures necessary to avoid even the appearance of a conflict of interest. Kayes v. Pacific Lumber Co., 51 F.3d 1449, 1465 (9th Cir. 1995).

Nowhere do Milberg Weiss= prior responses explain how it will avoid prejudice to the preferred purchaser plaintiffs, who were not Milberg=s clients. It essentially is undisputed that Milberg had never focused on the facts concerning the preferred stock purchasers and their claims, and cannot reasonably be expected to have focused on claims which were never pursued by the Regents. Indeed, this Court=s Opinion (at 25-29) details the extensive differences, which have been proffered by the Preferred Purchaser Plaintiffs, between the common and preferred claims.

IV. MILBERG'S BELATEDLY OBTAINED PREFERRED PURCHASER PLAINTIFFS ARE NOT ELIGIBLE TO REPRESENT MOST OF THE PREFERRED PURCHASERS ON MOST OF THEIR CLAIMS

In its Consolidated Complaint, Milberg lists as plaintiffs, individuals who purchased Enron preferred shares, but Milberg does not identify in the Consolidated Complaint which preferred share issues they purchased or when they purchased them. CC ¶¶ 81(l)-(n). A review of the plaintiff's certifications for these three individuals, Messrs. Schwartz, Berman and Smith (Docket number 443), demonstrates that Milberg's clients cannot sufficiently represent purchasers of Enron preferred stock. Mr. Smith's purchases (of Enron Capital LLC) began on October 23, 2001, after the first disclosures had occurred and after the first class action had been filed. Mr. Berman purchased an unidentified issue of Enron preferred in October 2000. And,

---

6 In a class action, the decision appointing lead counsel effectively results in the appointment of class counsel. In the class action context, the appearance of a conflict has the potential of unraveling any settlement and therefore unnecessarily prolonging litigation.

Mr. Schwartz purchased Enron Capital Trust I in December 1999, during the Federal Class Period.

Hence, none of Milberg's named plaintiffs who purchased Enron preferred shares made their purchases in the time period before the Federal Class Period when the facts arose concerning the claims unique to the preferred share purchasers. Named plaintiff Mr. Steiner purchased 585 shares of Enron Preferred R stock, at $25.50 per share (totaling $14,917.50) on July 8, 1997 during the earlier relevant time period. Steiner Amended Complaint ¶ 6. Furthermore, counsel for the Preferred Purchaser Plaintiffs have additional plaintiff's certifications from other clients who purchased in the initial public offerings of Capital Trusts I and II, but Milberg Weiss saw fit both to ignore these claims and to refuse to consult with the attorneys for the Preferred Purchaser Plaintiffs. As we have stated on a number of occasions, Milberg has no incentive to focus on the claims of Enron preferred stock purchasers as well as on the claims of Enron common stock purchasers.[7]

CONCLUSION

For the foregoing reasons, the preferred purchaser plaintiffs respectfully submit that their pending motions for clarification (with expedition) of this Court=s February 15, 2002 Opinion appointing lead plaintiff and lead counsel be in all respects granted and that this Court: (1) direct Milberg Weiss to file an Amended Consolidated Complaint alleging the omitted claims on behalf of Enron preferred stock purchasers and (2) appoint the attorneys for the Preferred Purchaser Plaintiffs to represent purchasers of Enron preferred stock in the same manner that the Berger &

[7] The Consolidated Complaint lists co-counsel for certain additional types of Enron securities despite the fact that only Milberg was appointed by this Court as lead counsel. Apparently, these concern Enron securities issues for which Milberg did not have a client-purchaser.

Montague law firm, and the Wolf Popper and Shapiro Haber & Urmy law firms, are herein representing the respective interests of the purchasers of certain Enron debt securities.

Dated: May 3, 2002

WOLF HALDENSTEIN ADLER FREEMAN & HERZ LLP

By: Daniel W. Krasner

Daniel W. Krasner by permission
Julie Sullivan
270 Madison Avenue
New York, New York 10016
(212) 545-4600
(212) 545-4653
www.whafh.com
Attorneys for Plaintiff

MCGEHEE & PIANELLI, L.L.P.
Jack E. McGehee, TBN 13623700, Fed No. 8163
James V. Pianelli TBN 15966740, Fed No. 11557
1225 N. Loop West, Suite 810
Houston, Texas 77008
(713) 864-4000
(713) 868-9393 fax
TEXLAW@LAWTX.COM
Local Counsel for the Preferred Purchaser Plaintiffs

268182